

Annual Report
2002

Online Document Management



datamark systems®
Integrated Document Solutions

About our Cover...

Datamark Systems offers one of the most complete and functional online document management solutions in the industry. Through secure links and confidential passwords, customers access complete information in real time about their business documents warehoused in our facilities. They can call up inventory data, requisition documents, track order status, view billing information, and print customized reports – all from their desktops.



Profile

Datamark Systems Group Inc. offers integrated document management and print solutions through a network of specialized manufacturing facilities and distribution warehouses located across Canada. Our main focus is business forms, pressure sensitive labels, tags and short to medium-run commercial printing.

Through our 750 experienced and dedicated employees, we provide efficient, dependable and rapid service to customers in Canada, the United States and internationally. We maintain our competitive position by continually expanding our product and service capabilities through ongoing investment and strategic acquisitions.

Founded in 1974, Datamark Systems is a public company listed on the Toronto Stock Exchange (TSX: DMK).



Message to Shareholders

As we expected, our financial results were lower in 2002 compared to the strong levels achieved in 2001. Mainly reflecting soft business conditions throughout the year, our sales declined 12% to \$113.3 million and net earnings decreased to \$2.9 million, compared to \$5.2 million in 2001.

During 2002, we renewed several major contracts, enhanced our document management offering and tightly managed our costs. We also improved our financial position by reducing our total debt to \$12.0 million from \$15.8 million in 2001.

Many months of serious negotiations and integration planning related to a significant transaction ended in disappointment in mid-2002 when the target company withdrew from the proposed deal. However, we completed a smaller acquisition in 2003 that strengthens our position in Western Canada.

Operations Review

Market conditions were difficult throughout the printing industry in 2002 and our sales were lower in each quarter compared to the corresponding periods of the previous year, particularly in the first half of the year. Several negative factors were at play, including the turmoil in the global travel industry, the continuing decline in demand for certain types of business forms, as well as lower promotional and advertising spending.

Business Forms

The past year was one of the leanest in terms of new business opportunities for the business forms division in a market characterized by overcapacity and very competitive pricing. As well, many of our existing contracts expired in 2002 and we devoted considerable time and effort in their renewal. Although we renewed all of our contracts, the division's sales and margins declined as many existing customers increased their use of electronic documents, laser printed business forms and other technologies. Our sales were also affected by a sharp decline in demand for carbonized paper airline tickets, mainly due to the growing acceptance of electronic tickets and reduced air travel worldwide.

Although demand is declining for certain types of business forms, the market remains substantial. In 2002, we continued to take steps to improve our offering, including our ability to design and manufacture value added form/label combinations, a segment of our business that is still growing.

Labels and Tags

Our labels and tags division increased its sales for the tenth consecutive year in 2002. Sales were up 13% compared to 2001 thanks to our strong positioning in form/label combinations as well as secondary and industrial labels, which are used mainly for product identification purposes. We expanded our offering to include prime labels used on consumer products and in packaging.

Since entering this business, we have earned a strong reputation for innovation, customer service and the ability to meet the most demanding technical requirements. We have invested continuously to increase production capacity and maintain high performance standards.

Commercial Printing

The commercial printing market was soft throughout 2002, leading to widespread price discounting. After five consecutive years of growth, this division recorded lower sales and margins compared to 2001.

During 2002, we enhanced our capabilities by investing in direct-to-plate technology and the most cost-efficient bindery equipment. Drawing on our expertise, we successfully expanded our product range by manufacturing high-end folding cartons. By penetrating this market, we are able to offer our complete document management solution, including printing, labels, warehousing and distribution to packaging customers.

Financial Highlights

For the Years Ended December 31

	2002	2001
Sales	\$ 113,250,775	\$ 128,642,728
Net Earnings	2,852,731	5,246,861
Dividends	1,945,282	3,801,548
Total Debt*	11,976,259	15,832,292
Total Assets	56,222,250	61,000,548

* Bank indebtedness, current maturity of long-term debt and long-term debt, less marketable securities

Strategic Initiatives

In 2002, we implemented a new online document management system which we believe to be the most functional and user-friendly in the industry. It allows our customers to access complete information in real time about their printed business documents warehoused in our facilities. They can call up inventory data, requisition documents, make payments, track order status, view billing information, and print customized reports – all from their desktops. This advanced online capability strengthens our offering and reinforces our position as a Canadian leader in one-stop integrated document management solutions.

This unique value-added service, which allows customers to efficiently manage their printed product inventories, differentiates Datamark Systems from competitors. It will be a valuable sales driver for our business forms, labels and commercial printing divisions in 2003 and future years.

In early 2003, we increased our market penetration in Western Canada and our ability to compete nationally by acquiring the operating assets of Sheraton Business Forms and Sheraton Labels. This transaction adds manufacturing facilities and a distribution warehouse in Calgary as well as sales offices in Calgary, Edmonton and Vancouver to our Canadian network. Sheraton's sales were \$9.5 million in 2002.

As a result of these initiatives, our integrated document management solutions are more attractive to mid and large-scale users of printed business documents.

Prospects

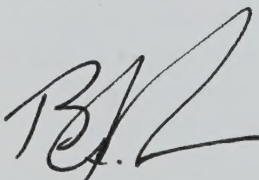
Although demand continued to be soft entering 2003 and we expect a very challenging year, our strategic initiatives will allow us to expand our business going forward.

We will focus on winning new contracts in 2003 by leveraging our enhanced competitive position resulting from our new online document management system and stronger presence across Canada since the Sheraton acquisition.

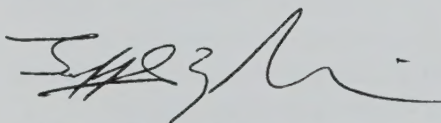
Our strong financial position is another important asset. It will allow us to capitalize on new acquisition opportunities to further strengthen our ability to serve customers.

Acknowledgements

We acknowledge the contribution of our employees to the Company's success and we thank our customers and suppliers for their continued support.



B. Jeffrey Parr
Chairman of the Board



Jeffrey Zunenshine
President and Co-Chief Executive Officer

Management Discussion and Analysis

Results of Operations

The Company's consolidated sales for the year ended December 31, 2002 decreased 12% to \$113,250,775 from \$128,642,728 for 2001. The decline in sales occurred mainly in the first half of 2002 and reflects three main factors, as follows:

- The non-renewal in the second quarter of 2001 of a major document management outsourcing contract, accounting for approximately \$7.5 million of the lower sales;
- A \$4.7 million decline in sales of carbonized paper airline tickets due to the growing acceptance of electronic tickets and continued weakness in the airline industry worldwide;
- Lower sales of commercial printing, reflecting the continuation of soft demand which began in the second half of 2001 as a result of a slowdown in advertising and promotional spending.

Cost of sales totaled \$81,232,757 for 2002, or 71.7% of sales, compared to \$90,326,419, or 70.2% of sales, for the same period of last year. Gross profit declined to \$32,018,018, or 28.3% of sales, compared to \$38,316,309, or 29.8% of sales, for 2001. This decrease is due primarily to lower average capacity utilization in 2002 compared to 2001.

Selling and administrative expenses declined to \$22,814,688 for 2002, compared to \$25,640,984 for the previous year, reflecting mainly lower sales expenses and tight cost management. As a percentage of sales, these expenses represent 20.1% for 2002 compared to 20.0% for 2001.

The Company wrote-off \$830,000 in legal and financial due diligence fees and commitment fees in 2002 related to a major acquisition opportunity which did not materialize. This amount is recorded in the 2002 statement of earnings as a non-operating item.

Amortization totaled \$2,909,058 compared to \$3,061,314 for 2001. The decrease is explained by the non-amortization of goodwill following the adoption of new accounting standards recommended by the Canadian Institute of Chartered Accountants. Goodwill was assessed for impairment during 2002 in accordance with the new standards and was not considered to be impaired. Goodwill amortization was nil for 2002 compared to \$279,616 for 2001.

Interest expense declined 76% to \$844,383 for 2002 compared to \$1,486,342 for the previous year. This decrease reflects the beneficial impact of a decline in interest rates and a lower average debt level for 2002 compared to 2001.

The effective tax rate for 2002 was 39.60% compared to 35.36% for 2001, reflecting mainly prior year tax reassessments for the periods 1997 to 2001 in the amount of \$194,000, which consisted mainly of the disallowance of certain deductions for manufacturing and processing.

Consequently, net earnings for 2002 were \$2,852,731 compared to \$5,246,861 for 2001. Basic earnings per share were \$0.23 for 2002 compared to \$0.44 for 2001. Of the decrease in basic earnings per share, the costs related to the unsuccessful acquisition accounted for \$0.04 and the tax reassessment \$0.02.

Balance Sheet

Current assets decreased to \$36,039,426 as of December 31, 2002, compared to \$40,193,248 at the end of 2001, a decline of 10.3%, primarily due to lower inventories and accounts receivable. Inventories decreased to \$15,796,928 at the end of 2002 from \$18,229,229 at the same time in the previous year, mainly due to lower sales volumes. For the same reason, accounts receivable declined to \$18,367,128 at the end of 2002 from \$19,645,200 at the end of 2001.

Net fixed assets decreased to \$11,589,644 compared to \$12,214,120 as of the end of 2001, mainly due to the difference between fixed assets purchased in 2002, totaling \$2,310,099, and disposals of fixed assets and amortization.

As a result of these factors, total assets declined to \$56,222,250 at the end of 2002, compared to \$61,000,548 at the end of 2001, a decrease of 7.8%.

Current liabilities decreased to \$14,858,869 from \$18,480,988 at the end of 2001. Bank indebtedness, used for working capital purposes, was \$2,158,023 as of December 31, 2002 compared to \$3,958,577 as of December 31, 2001.

Long-term debt, including current maturity, was reduced to \$10,238,465 at the end of 2002 from \$13,410,691 at the end of 2001. During 2002, the Company repaid \$3,612,226 of existing long-term debt and incurred new long-term debt of \$440,000, for a net reduction of \$3,172,226.

Liquidity and Financial Resources

Operating activities provided funds of \$5,870,947 for 2002 compared to \$8,709,983 for 2001. Non-cash operating elements of working capital provided funds of \$1,974,513 compared to \$5,557,620 for 2001. Including such elements, funds provided from operating activities were \$7,845,460 for 2002 and \$14,267,603 for 2001.

Financing activities utilized funds of \$6,861,764 for 2002, comprising dividends of \$1,945,282, repayment of long-term debt of \$3,612,226 and a reduction in bank indebtedness of \$1,800,554. The utilization of funds was partly offset by the issuance of common shares under the stock option plan in the amount of \$56,298 and an increase in long-term debt of \$440,000.

The major components in investing activities were additions to fixed assets of \$2,310,099 compared to \$1,940,870 for 2001. The Company expects additions to fixed assets of approximately \$1.8 million in 2003. Marketable securities of \$1,135,408 were cashed during 2002, of which \$1,050,000 was used to repay long-term debt.

After paying several special dividends in previous years, the Company's Board of Directors decided in 2001 to pay regular dividends on a quarterly basis. The quarterly dividend rate for 2002 was \$0.04 per share. The payment of dividends in each quarter is subject to approval by the Board of Directors following a review of several factors, including recent earnings, financial position and business prospects.

The Company has a credit facility of approximately \$17,000,000 of which more than \$14,000,000 was unused as of December 31, 2002. Management considers that cash flow from operations, the existing credit facility and availability of additional borrowings, if necessary, provide sufficient liquidity to meet debt repayments, working capital requirements, capital spending needs, dividend payments, and other financial obligations in 2003.

Factors Affecting the Business

The Company is sensitive to paper prices, its most important raw material. The Company monitors market developments and adjusts procurement decisions accordingly.

Total demand for business forms and commercial printing has been on a downward trend for over a decade but the overall market remains substantial, representing sales of over \$2 billion annually in Canada alone. Demand for certain types of business forms is declining as a result of the growing acceptance and availability of electronic business forms, technological advances in laser and on-demand printing, Internet communications, as well as other innovations. The Company is responding by offering integrated, one-stop document management solutions – including manufacturing, warehousing and distribution, as well as electronic order entry, inventory reporting and billing – that help customers lower the cost of paper-based business communications. A key factor in the Company's future competitiveness and profitability is its continued ability to be a low-cost supplier.

The Company is a major supplier of products and services to the global travel and transportation industry which continues to be in turmoil. Sales of carbonized paper airline tickets, one of the Company's specialty products, declined to \$10.3 million in 2002 from \$15 million in 2001 as a result of the growing acceptance of electronic tickets and a sharp decline in global air travel. In addition, the Company's largest customer filed for protection under the Companies' Creditors Arrangement Act in early 2003. As a result, the Company's sales to this customer and to the industry overall may experience further erosion.

The Company is a consolidator in its industry. It actively seeks opportunities to expand its customer base, geographic reach and product capabilities through mergers and acquisitions. The Company has successfully integrated several acquisitions in recent years and has gained valuable experience in capturing synergies and retaining customers following such transactions.

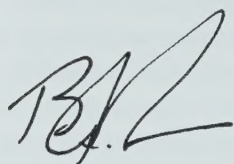
Management's Statement of Responsibility

The accompanying consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles, and the other financial information provided in the Annual Report, which is consistent with the financial statements, are the responsibility of management and have been approved by the Board of Directors.

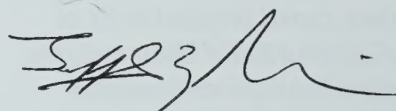
The consolidated financial statements include some amounts that are based on management's best estimates and judgment and, in their opinion, present fairly the Company's financial position, results of operations and cash flows. The Company's procedures and internal control systems are designed to provide reasonable assurance that accounting records are reliable and to safeguard the Company's assets.

The Audit Committee, consisting primarily of outside directors, is responsible for reviewing the consolidated financial statements and recommending their approval to the Board of Directors. In order to fulfill its responsibilities, the Audit Committee meets with management and external auditors to discuss internal control over the financial reporting process, significant accounting policies, other financial matters and the results of the examination by the external auditors.

These consolidated financial statements have been audited by the external auditors Richter, Usher & Vineberg, Chartered Accountants, and their report is included herein.



B. Jeffrey Parr
Chairman of the Board



Jeffrey Zunenshine
President and Co-CEO

Auditors' Report

To the Shareholders of **Datamark Systems Group Inc. - Groupe Datamark Systems Inc.**

We have audited the consolidated balance sheets of **Datamark Systems Group Inc. - Groupe Datamark Systems Inc.** as at December 31, 2002 and December 31, 2001 and the consolidated statements of earnings, retained earnings and cash flows for each of the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and December 31, 2001 and the results of its operations and its cash flows for each of the two years then ended in accordance with Canadian generally accepted accounting principles.



Richter Usher & Vineberg
General Partnership
Chartered Accountants

Montreal, Quebec
February 28, 2003
(except for note 16 which is dated April 1, 2003)

Consolidated Balance Sheet

As At December 31, 2002

	2002	2001
Assets		
Current		
Marketable securities	\$ 420,229	\$ 1,536,976
Accounts receivable	18,367,128	19,645,200
Income taxes recoverable	591,330	-
Inventories (note 3)	15,796,928	18,229,229
Other assets	863,811	781,843
	<u>36,039,426</u>	<u>40,193,248</u>
Fixed Assets (note 4)	11,589,644	12,214,120
Goodwill	8,593,180	8,593,180
	<u>\$ 56,222,250</u>	<u>\$ 61,000,548</u>

Liabilities

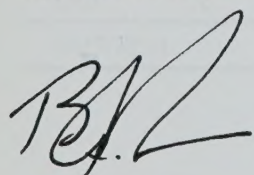
Current		
Bank indebtedness (note 5)	\$ 2,158,023	\$ 3,958,577
Accounts payable and accrued liabilities	10,272,052	10,458,151
Accrued pension liability (note 6)	285	71,136
Income taxes payable	-	685,960
Current maturity of long-term debt	2,428,509	3,307,164
	<u>14,858,869</u>	<u>18,480,988</u>
Long-Term Debt (note 7)	7,809,956	10,103,527
Future Income Taxes	1,479,090	1,270,090
Accrued Pension Liability (note 6)	-	33,216
Commitment and Contingency (note 9)		

Shareholders' Equity

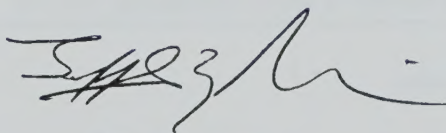
Capital Stock (note 10)	15,503,262	15,446,964
Retained Earnings	16,555,622	15,648,173
Foreign Currency Translation Adjustment (note 11)	15,451	17,590
	<u>32,074,335</u>	<u>31,112,727</u>
	<u>\$ 56,222,250</u>	<u>\$ 61,000,548</u>

See accompanying notes

Approved on behalf of the Board:



B. Jeffrey Parr
Director



Jeffrey Zunenshine
Director

Consolidated Statement of Retained Earnings

For the Year Ended December 31, 2002

	2002	2001
Balance - Beginning of Year	\$ 15,648,173	\$ 14,202,860
Net earnings	2,852,731	5,246,861
	18,500,904	19,449,721
Dividends	1,945,282	3,801,548
Balance - End of Year	\$ 16,555,622	\$ 15,648,173

See accompanying notes

Consolidated Statement of Earnings

For the Year Ended December 31, 2002

	2002	2001
Sales	\$ 113,250,775	\$ 128,642,728
Costs and Expenses		
Cost of sales	81,232,757	90,326,419
Selling and administrative	22,814,688	25,640,984
Amortization	2,909,058	3,061,314
Loss (gain) on disposal of fixed assets	(99,842)	10,808
Interest on long-term debt	679,871	932,635
Other interest	164,512	553,707
	107,701,044	120,525,867
Operating Income Before the Undernoted Item	5,549,731	8,116,861
Write-off of unsuccessful acquisition costs	830,000	-
Earnings Before Income Taxes	4,719,731	8,116,861
Income taxes (note 13)		
Current	1,658,000	2,479,000
Future	209,000	391,000
	1,867,000	2,870,000
Net Earnings	\$ 2,852,731	\$ 5,246,861
Earnings Per Share (note 14)	\$ 0.23	\$ 0.44
Diluted Earnings Per Share (note 14)	\$ 0.23	\$ 0.43
Weighted Average Number of Shares Outstanding (note 14)	12,154,995	11,877,557

See accompanying notes

Consolidated Statement of Cash Flows

For the Year Ended December 31, 2002

	2002	2001
Funds Provided (Used) -		
Operating Activities		
Net earnings	\$ 2,852,731	\$ 5,246,861
Amortization	2,909,058	3,061,314
(Gain) loss on disposal of fixed assets	(99,842)	10,808
Future income taxes	209,000	391,000
	5,870,947	8,709,983
Changes in non-cash operating elements of working capital	1,974,513	5,557,620
	7,845,460	14,267,603
Financing Activities		
Bank indebtedness	(1,800,554)	(5,490,903)
Issue of common shares	56,298	428,810
Increase in long-term debt	440,000	1,317,000
Repayment of long-term debt	(3,612,226)	(2,791,309)
Dividends	(1,945,282)	(3,801,548)
	(6,861,764)	(10,337,950)
Investing Activities		
Business acquisition	-	(1,736,949)
Purchase of marketable securities	(18,661)	(291,485)
Sale of marketable securities	1,135,408	-
Additions to fixed assets	(2,310,099)	(1,940,870)
Disposal of fixed assets	211,795	23,654
Foreign currency translation adjustment	(2,139)	15,997
	(983,696)	(3,929,653)
Cash - End of Year	\$ -	\$ -

See accompanying notes

Additional Cash Flow Information

Interest paid	\$ 823,427	\$ 1,464,854
Income taxes paid	2,935,290	724,729

Notes to Consolidated Financial Statements

December 31, 2002

1. Nature of Business

The Company operates in the printing industry and produces forms, labels and commercial printing for a diversified clientele located in Canada, the United States and international markets.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Datamark Systems Group Inc. - Groupe Datamark Systems Inc. and its subsidiary companies. On consolidation, all material intercompany balances and transactions have been eliminated.

Revenue Recognition

Sales are recognized when the goods are shipped or placed in the Company's secure storage facility at the customer's request.

Valuation of Inventories

Inventories are stated at the lower of cost (first-in, first-out method) and net realizable value.

Amortization

On the declining balance method –

Furniture and fixtures	20%
Data processing equipment	30%
Rolling stock	30%

On the straight-line method –

Machinery and equipment	three to ten years
Leasehold improvements	over the term of the lease

Future Income Taxes

The Company follows the liability method with respect to accounting for income taxes. Future tax assets and liabilities are determined based on differences between the carrying amount and the tax basis of assets and liabilities (temporary differences). Future income tax assets and liabilities are measured using the enacted tax rates that will be in effect when these differences are expected to reverse. Future income tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not that the assets will be realized.

Employee Benefit Plan

The cost of pensions earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalations and retirement ages of employees.

For the purposes of calculating the expected return on plan assets, those assets are valued at fair value.

Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plan is 21 years.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

Stock-Based Compensation

The Canadian Institute of Chartered Accountants ("CICA") has issued a new accounting standard for stock-based compensation and other stock-based payments which is effective for fiscal year 2002. The new standard requires the use of a fair value-based method to account for certain stock-based compensation arrangements. Options granted by the Company to employees are not required under the new standard to be accounted for using a fair value-based method. When an enterprise does not use the fair value-based method for accounting, it must disclose pro forma net earnings and pro forma earnings per share, as if the fair value-based accounting method had been used to account for stock-based compensation cost.

The Company will continue to use the settlement method to account for the employees stock options granted under the stock-based compensation plan described in note 10. As a result, no compensation expense is recognized when stock options are issued to employees. Any consideration paid by employees upon exercise of stock options is credited to share capital.

Notes to Consolidated Financial Statements

December 31, 2002

2. Summary of Significant Accounting Policies (cont'd)

Use of Estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired.

The CICA recently issued Handbook Sections 1581, "Business Combinations" and 3062, "Goodwill and Other Intangible Assets".

Effective January 1, 2002, the Company adopted the provisions of the new Handbook Sections and accordingly is no longer amortizing goodwill.

In addition, goodwill will be assessed for impairment on an annual basis in accordance with the new standards.

The following is a reconciliation of net earnings to reflect the impact of no longer amortizing goodwill effective January 1, 2002.

	2002	2001
Reported net earnings	\$ 2,852,731	\$ 5,246,861
Goodwill amortization	-	279,616
Adjusted net earnings	\$ 2,852,731	\$ 5,526,477
<hr/>		
Reported earnings per share	0.23	0.44
Goodwill amortization	0.00	0.02
Adjusted basic and diluted earnings per share	\$ 0.23	\$ 0.46

Earnings Per Share

In 2001, the Company adopted the new recommendations of the CICA's Handbook with respect to earnings per share. Under the new recommendations, the diluted net earnings per share are calculated based on the weighted average number of common shares outstanding during the year, plus the effects of dilutive common share equivalents such as options. This method requires that diluted earnings per share be calculated using the treasury stock method and the calculation is made on the basis that all common share equivalents had been exercised at the beginning of the reporting period or at the date of issue as the case may be, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period.

Foreign Currency Translation

Accounts in foreign currency have been translated into Canadian dollars as follows:

Self-sustaining foreign operations:

Assets and liabilities - at exchange rates in effect at the balance sheet date;

Revenue and expenses - at average exchange rates prevailing during the year.

Gains and losses arising from foreign currency translation are deferred and included as a separate component of shareholders' equity.

Other accounts not covered above have been translated as follows:

Monetary items - at exchange rates in effect at the balance sheet date;

Revenue and expenses - at average exchange rates prevailing during the year, except for inventories and amortization which are translated at rates prevailing when the related assets were acquired.

Gain and losses arising from foreign currency translation are included in income.

Notes to Consolidated Financial Statements

December 31, 2002

3. Inventories

	2002	2001
Raw materials	\$ 5,457,745	\$ 6,499,666
Work in process	1,306,177	1,521,462
Finished goods	9,033,006	10,208,101
	\$ 15,796,928	\$ 18,229,229

4. Fixed Assets

		2002	
	Cost	Accumulated Amortization	Net Carrying Amount
Machinery and equipment	\$ 43,703,012	\$ 34,264,752	\$ 9,438,260
Furniture and fixtures	2,356,744	1,845,037	511,707
Data processing equipment	4,181,622	3,378,695	802,927
Leasehold improvements	2,661,620	1,824,870	836,750
	\$ 52,902,998	\$ 41,313,354	\$ 11,589,644

		2001	
	Cost	Accumulated Amortization	Net Carrying Amount
Machinery and equipment	\$ 43,135,670	\$ 33,371,855	\$ 9,763,815
Furniture and fixtures	2,993,749	2,408,160	585,589
Data processing equipment	4,070,926	3,125,521	945,405
Rolling stock	68,916	68,916	-
Leasehold improvements	2,680,629	1,761,318	919,311
	\$ 52,949,890	\$ 40,735,770	\$ 12,214,120

5. Bank Indebtedness

The Company has a credit facility of approximately \$17,000,000. The credit facility consists of an operating line of credit, letters of credit, letters of guarantee and banker's acceptances. Borrowings under the letters of credit and letters of guarantee facilities are limited to \$5,000,000. Borrowings under the credit facility bear interest at rates varying between the bank's prime rate plus 0.5% and the bank's prime rate plus 0.75%. As security, the Company has pledged its book debts and inventories. The terms of the banking agreement, which is subject to renegotiation on an annual basis, require the Company to comply with certain financial covenants.

6. Employee Future Benefits

The Company maintains a defined benefit pension plan for which actuarial reports are prepared every three years, the most recent of which was prepared as at December 31, 2001. The Company had appropriate projections prepared by an independent actuary for the year ended October 31, 2002 as a proxy for December 31, 2002.

Notes to Consolidated Financial Statements

December 31, 2002

6. Employee Future Benefits (cont'd)

Information about the Company's defined benefit plan is as follows:

	2002	2001
Plan assets		
Fair value at November 1, 2001	\$ 1,180,473	\$ 962,155
Actual return on plan assets	43,933	40,952
Employer contributions	193,353	249,906
Benefits paid	(92,580)	(72,540)
Fair value at October 31, 2002	\$ 1,325,179	\$ 1,180,473
Accrued benefit obligations		
Balance at November 1, 2001	\$ 1,391,292	\$ 1,250,294
Current service cost	87,480	91,296
Interest cost	86,796	68,232
Actuarial losses	83,912	54,010
Benefits paid	(92,580)	(72,540)
Balance at October 31, 2002	\$ 1,556,900	\$ 1,391,292
Funded status - plan deficit	(231,721)	(210,819)
Unamortized net actuarial loss	216,246	90,107
Accrued pension liability	(15,475)	(120,712)
Contributions made, November 1 to December 31, 2002	15,190	16,360
	(285)	(104,352)
Less: current portion	285	71,136
	\$ -	\$ (33,216)

The significant actuarial assumptions adopted in measuring the Company's accrued pension liability included a discount rate of 6.25% (2001 - 6.25%) and an expected long-term rate of return on plan assets of 7% (2001 - 7%).

The Company's net pension expense consists of the following:

	2002	2001
Current service cost	\$ 87,480	\$ 91,296
Interest cost	86,796	68,232
Expected return on plan assets,	(86,160)	(73,559)
Previous year current service cost,		
estimate to November 1 to December 31, 2001	(18,576)	18,576
Estimated current service cost,		
November 1 to December 31, 2002	14,220	-
Net pension expense (included in selling and administrative)	\$ 83,760	\$ 104,545

Notes to Consolidated Financial Statements

December 31, 2002

7. Long-Term Debt

	2002	2001
Debenture bearing interest at an average cost of short-term funds plus 2.375%, maturing March 2003 and payable in monthly principal instalments of \$20,000	\$ 60,000	\$ 300,000
Term debt, bearing interest at 5.41% per annum	–	1,050,000
Term debt secured by machinery and equipment having an approximate net carrying amount of \$149,000, bearing interest at 5.34% per annum, maturing March 10, 2003	350,000	350,000
Term bank loan secured by machinery and equipment having an approximate net carrying amount of \$1,338,000, bearing interest at 5.05% per annum, maturing October 2009 and repayable in monthly principal instalments of \$12,500	1,025,000	1,175,000
227,106 (2001 - 581,106) non-voting, non-participating preferred shares, redeemable (at the amount paid thereon) no later than May 31, 2004 and retractable (based on a formula), with a minimum repurchase of \$85,000 per year	227,106	581,106
Term bank loan secured by machinery and equipment having an approximate net carrying amount of \$439,000, bearing interest at 0.75% above the lender's floating base rate, maturing July 2007 and repayable in monthly principal instalments of \$7,333	403,333	–
Term debt secured by machinery and equipment having an approximate net carrying amount of \$101,000, bearing interest at 9% per annum, maturing April 2004 and repayable in quarterly instalments of \$11,162 including interest	63,026	99,585
Loan payable, bearing interest at 2.25% above the lender's floating base rate, maturing in 2007, repayable in monthly instalments varying from \$145,000 to \$200,000	8,110,000	9,855,000
	10,238,465	13,410,691
Current maturity	2,428,509	3,307,164
	\$ 7,809,956	\$ 10,103,527

The debenture which is subordinated to the bank (note 5) is secured by all the assets (other than receivables and inventories) of a subsidiary company, having an approximate net carrying amount of \$4,934,000. The loan payable is secured by all the assets of the Company, subject to the prior rights of the Company's banker and the debenture holder.

Principal repayments on long-term debt due in each of the next five years are approximately as follows:

2003	\$ 2,429,000
2004	2,256,000
2005	1,978,000
2006	1,978,000
2007	1,351,000

8. Immigrant Investors Loan

A term debt of \$400,000 obtained under the Immigrant Investors Program (the "Program"), bearing interest at 2.73%, maturing on March 10, 2003, has been effectively defeased through a transaction whereby the Company acquired \$400,000 of term deposits bearing interest at 2.73% maturing on March 10, 2003. Under the terms of the Program, the sole purpose of the term deposits is to fund scheduled payments of interest and principal of the term debt and accordingly both the liability and the related qualifying assets have been omitted from the balance sheet.

Notes to Consolidated Financial Statements

December 31, 2002

9. Commitment and Contingency

The aggregate minimum rentals for leases in effect as at December 31, 2002 are approximately as follows:

2003	\$ 1,699,000
2004	1,451,000
2005	861,000
2006	566,000
2007	322,000

In addition, the Company has furnished for tenders, letters of guarantees amounting to \$211,000.

10. Capital Stock

	2002	2001
Authorized without limit as to number and without par value - preferred shares issuable in series common shares Issued - 12,158,111 (2001 - 12,114,711) common shares	\$ 15,503,262	\$ 15,446,964

During the year, the Company issued 43,400 (2001 - 361,000) common shares for cash consideration of \$56,298 (2001 - \$428,810).

Share Option Plan

The Company has a share option plan under which it may grant options to key employees, senior executives and directors of the Company and its subsidiary companies to purchase common shares. Options have a maximum exercise period of 10 years and are granted at a price not less than the average market value of the common shares on the previous five business days before the date on which the options are granted. The options vest in increments of 20% per year beginning on the date on which the option is granted. The Company has reserved 990,000 shares for issuance under the share option plan.

As at December 31, 2002, 747,079 (2001 - 596,428) options were outstanding 523,963 (2001 - 379,637) of which were exercisable as follows:

	2002			2001		
Expiry Date	Number of Options Outstanding	Number of Options Exercisable	Exercise Price	Number of Options Outstanding	Numbers of Options Exercisable	Exercise Price
March 20, 2002	–	–	\$ –	37,400	29,920	\$ 1.17
March 20, 2007	320,000	320,000	1.17	320,000	256,000	1.17
July 27, 2008	187,579	150,063	2.09	109,528	65,717	2.09
October 7, 2009	70,000	42,000	2.02	70,000	28,000	2.02
March 28, 2011	59,500	11,900	2.05	59,500	–	2.05
June 26, 2012	110,000	–	3.35	–	–	–
	747,079	523,963		596,428	379,637	

Notes to Consolidated Financial Statements

December 31, 2002

10. Capital Stock (cont'd)

The number of options has varied as follows:

	2002		2001	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Balance Outstanding - Beginning of Year	596,428	\$ 1.53	991,579	\$ 1.42
Granted	110,000	3.35	59,500	2.05
Exercised	(43,400)	1.30	(361,000)	1.19
Reinstated	84,051	2.09	—	—
Expired	—	—	(84,051)	2.09
Cancelled	—	—	(9,600)	1.23
Balance Outstanding - End of Year	747,079	1.87	596,428	1.53
Balance Exercisable - End of Year	523,963	1.52	379,637	1.39

The following outlines the impact and the assumptions used if the compensation for the Company's stock options was determined under the fair value based method of accounting for awards granted after January 1, 2002:

Net earnings, as reported	\$ 2,852,731
Pro forma impact	(118,797)
Pro forma net earnings	2,733,934
Pro forma basic and diluted earnings per share	0.22

Assumptions used in Black Scholes options pricing model:

Expected dividend yield	5.34%
Expected volatility	36.00%
Risk-free interest rate	4.96%
Expected life (years)	7

The fair value of options granted and reinstated during the year were \$0.79 and \$1.31 per unit respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's options and rights have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employees' stock options.

11. Foreign Currency Translation Adjustment

	2002		2001	
Balance - Beginning of Year	\$	17,590	\$	1,593
Translation adjustment		(2,139)		15,997
Balance - End of Year	\$	15,451	\$	17,590

12. Financial Instruments

Credit risk

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of each new customer. The Company does not have a significant exposure to any individual customer or counter party. The Company establishes an allowance for doubtful accounts that corresponds to the credit risk of its specific customers, historical trends and economic circumstances.

The Company does not believe that it is exposed to an unusual level of customer credit risk.

Notes to Consolidated Financial Statements

December 31, 2002

12. Financial Instruments (cont'd)

Fair Value

Accounts receivable, bank indebtedness, accounts payable and accrued liabilities are all short-term in nature and as such, their carrying values approximate fair values.

The estimated fair value of marketable securities, based upon quoted value, approximates their carrying value.

The carrying value of long-term debt bearing interest at rates which change with market rates approximates fair value.

The fair value of the balance of long-term debt, bearing interest at fixed rates or non-interest bearing, is calculated based on discounted future cash flow using the current market rate for similar long-term debt and approximates carrying value.

13. Income Taxes

The balance of future income taxes at December 31, 2002 represents mainly the tax effect of the excess of net carrying amount over the undepreciated capital cost of fixed assets arising from the difference between the Company's amortization rates and those prescribed for income tax purposes.

	2002	2001
Statutory tax rate	36.59%	39.22%
Statutory income taxes on earnings before income taxes	1,726,950	3,183,433
Manufacturing tax rate reduction	(152,950)	(400,433)
Prior years' tax reassessments	194,000	—
Other	99,000	87,000
	1,867,000	2,870,000
Effective tax rate	39.60%	35.36%

Significant components of the income tax expenses are as follows:

	2002	2001
Current tax expense	\$ 1,658,000	\$ 2,479,000
Future tax expense relating to origination and reversal of temporary differences	206,000	407,000
Effect of changes in income taxes rates	3,000	(16,000)
Income tax expense	\$ 1,867,000	\$ 2,870,000

14. Earnings Per Share

The calculation of basic earnings per share and diluted earnings per share is as follows:

	2002	2001
Basic Earnings Available to Common Shareholders	\$ 2,852,731	\$ 5,246,861
Weighted Average Number of Common Shares Outstanding	12,154,995	11,877,557
Basic Earnings Per Share	\$ 0.23	\$ 0.44
Weighted average number of common shares outstanding	12,154,995	11,877,557
Common share equivalents:		
Assumed exercise of outstanding dilutive options	637,079	680,479
Shares repurchased from proceeds of assumed exercise of options	(329,014)	(424,263)
Weighted Average Number of Common Shares and Common Share Equivalents Outstanding	12,463,060	12,133,773
Diluted Earnings Per Share	\$ 0.23	\$ 0.43

Notes to Consolidated Financial Statements

December 31, 2002

14. Earnings Per Share (cont'd)

Options have a dilutive effect when the average market price of the common shares during the period exceeds the exercise price of the options. As a result, 110,000 (2001 - Nil) anti-dilutive options have been excluded from the calculation of diluted earnings per share in 2002.

15. Geographic Information

Revenues from external customers, attributed to countries based on the location of the customer, are approximately as follows:

	2002	2001
Revenues from Canada	\$ 100,793,000	\$ 113,206,000
Revenues from other	12,458,000	15,437,000
Total Revenues	\$ 113,251,000	\$ 128,643,000

Substantially all fixed assets are located in Canada.

16. Subsequent Event

On April 1, 2003, the Company acquired the assets and businesses of Sheraton Business Forms Ltd. and Sheraton Labels Ltd., companies in the printing industry, for a total consideration of approximately \$2,802,000. The acquisition will be accounted for as a purchase. The consideration paid will be allocated to the assets acquired based on their fair values.

The transaction can be summarized as follows:

Net assets acquired:	
Accounts receivable	\$ 1,261,000
Inventories	752,000
Fixed assets	789,000
	\$ 2,802,000

As consideration for the purchase, \$1,997,000 was paid in cash at closing with a balance of purchase price of \$805,000 payable in April 2004. The balance of purchase price is non-interest bearing unless a default on payment occurs whereby the balance of purchase price would bear interest at the bank's prime rate plus 1%.

Concurrent with the above purchase, the Company entered into a consulting agreement with the vendor for the payment of a maximum fee of \$700,000 the determination of which is based on sales of the businesses acquired.

17. Comparative Figures

Certain reclassifications of 2001 amounts have been made to facilitate comparison with the current year.

Shareholder Information

ANNUAL MEETING OF SHAREHOLDERS

June 26, 2003 at 10:00 a.m.
Fairmont Queen Elizabeth
Gatineau Room
900 René-Lévesque Blvd. W.
Montreal, Quebec

AUDITORS

RICHTER, USHER & VINEBERG

Chartered Accountants
Montreal, Quebec

ERNST & YOUNG

Chartered Accountants
Winnipeg, Manitoba

RAYMOND, CHABOT, GRANT, THORNTON

Chartered Accountants
Montreal, Quebec

TRANSFER AGENT AND REGISTRAR

COMPUTERSHARE TRUST COMPANY OF CANADA

Montreal, Quebec

LEGAL COUNSEL

SPIEGEL SOHMER

Montreal, Quebec

AIKINS, MACAULAY & THORVALDSON

Winnipeg, Manitoba

ANNUAL INFORMATION FORM

Copies of the Annual Information Form
are available upon request.

SUBSIDIARIES

Datamark Systems Inc.
Les Impressions Intra Media Inc.
Proforms

BANKS

Roynat Inc.
National Bank of Canada

STOCK LISTING

Toronto Stock Exchange
Stock Symbol: DMK

COMMON SHARE TRADING

	2002	2001
High	4.00	3.46
Low	2.31	1.61
Close	2.65	3.28

Board of Directors

B. Jeffrey Parr

Chairman of the Board
DATAMARK SYSTEMS GROUP INC.
Co-CEO, Managing Director
and Director
CLAIRVEST GROUP INC.

Jeffrey Zunenshine*

President and Co-CEO
DATAMARK SYSTEMS GROUP INC.

Claude Perrotte

Executive Vice-President and Co-CEO
DATAMARK SYSTEMS GROUP INC.

H. Thomas Beck

President
FERNHILL HOLDINGS LTD.

Sydney C. Cooper

President
TORIL HOLDINGS LIMITED

John Fisher*

Managing Director
CLAIRVEST GROUP INC.

Donald R. Howe

President
3821137 MANITOBA LTD.

Normand Boulay*

Senior Investment Advisor
FONDS DE SOLIDARITÉ DES
TRAVAILLEURS DU QUÉBEC (FTQ)

Edward H. Reiman

Director

*Member of the Audit Committee

Management

Jeffrey Zunenshine

President
and Co-Chief Executive Officer

Claude Perrotte

Executive Vice-President
and Co-Chief Executive Officer

Luigi Fuoco

Chief Financial Officer

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